

General Information Letter: Petition to use alternative apportionment method cannot be granted without some showing that statutory apportionment formula fails to properly reflect the extent of the taxpayer's business activity in Illinois.

February 22, 2001

Dear:

This is in response to your letter dated February 20, 2001, in which you request permission to allocate to Illinois share of the business income of xxxxxxxxxxxxxxxxxxxxxxxxx, accruing to its Illinois member, rather than by using the statutorily-mandated apportionment formula, pursuant to Section 304(f) of the Illinois Income Tax Act (the "IITA"; 35 ILCS 101 *et seq.*). The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), which may be found on the Department's web site at [www.revenue.state.il.us](http://www.revenue.state.il.us). For the reasons discussed below, your petition cannot be granted at this time.

In your letter you have stated the following:

I am submitting this "Petition for Alternative Allocation and Apportionment" under Illinois Department of Revenue Regulations Section 100.3390 as managing member of xxxxxxxxxxxxxxxxxxxxxxxxx ("xxx"), and Alabama limited liability company that earns income from performing personal services. Since its inception in April 1996, xxx has filed federal Form 1065 on the cash method of accounting using the calendar year as its tax year. xxx has three business locations and five individual members – xxxxxx, Alabama (3 members work at this location), xxxxx, North Carolina (1 member), and xxxxxxxxx, Illinois (1 member). Calendar year 2000 was the first year in which xxx earned income in Illinois.

xxx keeps its books and records and reports business income (except for overnight sweep interest income earned on the operating checking account and carrying charges on accounts receivable) and expenses on federal Form 1065 as follows. Income that is earned by the personal efforts of a member working from his base office is specially allocated to that member. Business expenses of xxx are allocated among the members in three ways. First, annual meeting expenses are shared equally among all the members. Second, if the member has been a member of xxx for less than 12 months, then the member receives a special allocation of total expenses (less annual meeting expenses) equal to 30% of the income that was allocated to the member, resulting in net income for that member equal to 70% of the income allocation. If the member has been a member for 12 months or more, then that member shares equally with all "12 months or more" members in total expenses reduced by the annual meeting expenses and amounts specially allocated to "less than 12 month members" (the 30% amounts referred to in the immediately preceding sentence). Overnight sweep interest income earned on the operating checking account, carrying charges on accounts receivable, and nonbusiness income are specially allocated equally among the "12 months or more" members. The members' capital accounts are adjusted in accordance with this

method and the members believe that it is a fair and reasonable method of determining each member's net income from xxx.

The method proposed by xxx for Illinois follows the immediately preceding paragraph and results in net income of \$48,374 being allocated to the Illinois resident member for 2000. xxx suggests that this would be Illinois net income because the Illinois resident member produced this income from his base office in Illinois. None of the Illinois nonresident members would receive an allocation of Illinois income, since none of their income was earned while working from a base in Illinois. Going on to the personal income tax return level, the Illinois resident member would report \$48,374 in Illinois income, while the Illinois nonresident members would not report any income to Illinois. This method results in a fair and accurate allocation of income to Illinois based on the location of the business activity that produced the income.

The method of allocating and apportioning income on Illinois Form IL-1065 uses a single factor (sales) to apportion income among the states in which a business has activity. The income so apportioned to Illinois is then further allocated among the members based on their share of income percentages. This method would apportion \$47,503 of net income to Illinois. The Illinois resident member would apportion 5.67% of this on his Illinois personal income tax return, or \$2,693. This percentage is determined by dividing his federal net income from xxx by xxxxx total federal net income. The Illinois nonresident members would then report the remaining 94.33% of the net income, or \$44,810, on Illinois nonresident personal income tax returns, or else xxx would have to file an Illinois composite return Form IL-1023 for them. Under the Form IL-1023 method, then, the resident member reports Illinois net income that is substantially less than that produced by his Illinois business activity, and the nonresident members would have income taxed by Illinois even though none of them work from a base office in Illinois. This does not fairly reflect the income produced by the business activity in Illinois.

The members of xxx feel that the method proposed by them fairly allocates income to Illinois and results in accurate amounts of income tax paid to Illinois.

## **Response**

Section 304(f) of the IITA provides:

If the allocation and apportionment provisions of subsections (a) through (e) and of subsection (h) do not fairly represent the extent of a person's business activity in this State, the person may petition for, or the Director may require, in respect of all or any part of the person's business activity, if reasonable:

- (1) Separate accounting;
- (2) The exclusion of any one or more factors;

(3) The inclusion of one or more additional factors which will fairly represent the person's business activities in this State; or

(4) The employment of any other method to effectuate an equitable allocation and apportionment of the person's business income.

Taxpayers who wish to use an alternative method of apportionment under this provision are required to file a petition complying with the requirements of 86 Ill. Adm. Code Section 100.3390, which may be found on the Department's web site at [www.revenue.state.il.us](http://www.revenue.state.il.us).

Please note that your understanding of how partners and partnerships are taxed by Illinois appears to be erroneous. As a limited liability company that has elected to be treated as a partnership for federal income tax purposes, xxxxxxxxxxxxxxxxxxxxxxxxx, is a partnership for Illinois income tax purposes. See Section 1501(a)(16) of the IITA. As a partnership, it is by definition a nonresident. See Section 1501(a)(14) and (20) of the IITA.

A partnership is required to apportion its business income to Illinois in the same manner as any other nonresident taxpayer. See Section 305(c) of the IITA. Nonresident partners must then allocate to Illinois their partnership share of the business income so apportioned to Illinois by the partnership. See Section 305(a) of the IITA. However, an Illinois resident partner is subject to Illinois income tax on his entire share of the income of the partnership, not merely the Illinois portion of that income. See Sections 301(a) and 305(d) of the IITA.

Your petition contains no evidence that the statutory apportionment formula provided in Section 304(a) of the IITA fails to fairly represent the extent of the business activity of xxxxxxxxxxxxxxxxx, in Illinois. The allocation of income and expenses to the Illinois resident member do not necessarily reflect the extent of his activities in Illinois on behalf of xxxxxxxxxxxxxxxxx, relative to the activities of the Illinois resident member, the other members and any employees on behalf of xxxxxxxxxxxxxxxxx outside Illinois.

Moreover, your petition contains no basis for concluding that the nonresident members in xxxxxxxxxxxxxxxxx, are not deriving income from Illinois. As members of xxxxxxxxxxxxxxxxx, they are not conducting sole proprietorships. Each member is acting on behalf of xxxxxxxxxxxxxxxxx, xxxxxx, and each is entitled to a share of its profits, which are earned in part in Illinois. The nonresident members should therefore be subject to Illinois income tax.

Please note that 86 Ill. Adm. Code Section 100.3390(e)(1) requires a petition to be filed at least 120 days prior to the due date (including extensions) for the first return for which permission is sought to use the alternative apportionment method. A petition filed February 20, 2001 will allow a taxpayer to use the requested method on original returns due on or after June 20, 2001, if granted.

As stated above, this is a general information letter which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you still believe that your petition should be granted, please supplement the petition in accordance with the provisions of 86 Ill. Adm. Code Section 100.3390. If you have any questions, you may contact me at (217) 782-7055.

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Sincerely,

Paul S. Caselton  
Deputy Chief Counsel -- Income Tax